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SIPDIS

DEPT FOR EUR/RUS, EEB/ESC/IEC GALLOGLY AND GREENSTEIN,
S/EEE MORNINGSTAR
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SUBJECT: SPECIAL ENVOY MORNINGSTAR'S ENERGY CONSULTATIONS
IN MOSCOW

REF: A. MOSCOW 2541
[1](#)B. MOSCOW 1120

Classified By: EconMinCouns Matthias Mitman for Reasons 1.4 (b/d)

Summary

[1](#)1. (C) In separate meetings with Ambassador Morningstar, representatives from TNK-BP, Rosneft, and the MFA independently indicated that the recent financial crisis has opened up opportunities for greater foreign participation in Russia's hydrocarbon sector. Each noted the impact of lower European gas demand and prices on Gazprom, and all agreed China's role with regard to both Russian and Central Asian energy resources would continue to grow. DFM Denisov specifically addressed the GOR's desire for a new "legally binding" international framework related to energy, and urged a "very careful" U.S. approach to trans-Caspian transportation projects in order to avoid potential "unpredictable consequences." End summary.

RUSSIAN OIL AND GAS SECTOR

[1](#)2. (C) During his October 11 - 14 visit to Moscow, Special Envoy for Eurasian Energy Richard Morningstar consulted with a range of private sector and government officials. In separate meetings with TNK-BP Chief Operating Officer Bill Schrader, Rosneft Vice President Peter O'Brien, and First Deputy Foreign Minister Andrey Denisov, SE Morningstar discussed investment prospects in Russia's oil and gas sector, the future of gas relations and Gazprom, the role of China, the Caspian region, and bilateral and multilateral cooperation.

[1](#)3. (C) In discussing the Russian oil and gas sector, TNK-BP COO Bill Schrader (protect) emphasized Russia's enormous resource potential. He contrasted the IOCs, which he said are "talent rich and resource poor," with Russian oil and gas companies, which he said have access to resources, but not the best people with which to maximize the benefits of their assets. Schrader, who stressed that he now works for TNK-BP, not BP (his previous employer), said BP understands how to work in the Russian market much better now than it did a few years ago when it became a partner in TNK-BP. He said the reality is that foreign companies who want to do business in

Russia need to adapt to the business environment here and avoid coming in here as "bullies" who dictate terms. He added that the GOR, for its part, needs to ensure that whatever rules it creates are stable -- "companies are willing to invest, but they need to be certain the rules won't change." Schrader's international affairs advisor, Alexander Mikhailiants (protect), added that the economic crisis has altered the mindset of the Russian government and of TNK-BP's Russian shareholders, making the Russians much more receptive to foreign investment and expertise.

14. (C) Rosneft's Vice President for Finance, Peter O'Brien (protect), told SE Morningstar in a separate meeting that Rosneft and other Russian oil and gas companies could benefit from sharing risk with foreign partners and from the project management expertise that international oil companies (IOCs) could bring. He said access to financial capital is less an issue than the IOCs' "ability to execute projects and control costs." Noting that the economic crisis had helped improve the investment climate, he added that "everyone would have been better off in the long-run if oil prices had stayed low for a while longer." O'Brien said recent tax incentives have helped raise production levels, but that production would drop within a year if the GOR did not enact broader reforms. In response to SE Morningstar's questions regarding the appropriate role of the USG, O'Brien offered that while the USG is the natural counterpart to the GOR, the USG should allow the private sector to lead the discussion.

15. (C) In a meeting with DFM Denisov and other MFA officials, SE Morningstar stressed, among other topics, the importance

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of enhancing two-way investment between Russia and the U.S. Emphasizing the continued importance of hydrocarbons to the bigger energy picture, DFM Denisov welcomed U.S. and other foreign investment in the Russian energy sector. He stressed that Russia wants to regain the interest of U.S. companies in the broader Russian economy, "and not just in the oil and gas sector."

THIRD-PARTY ACCESS, GAZPROM, EUROPE

16. (C) O'Brien and Schrader both expressed frustration with Gazprom, the state-owned corporation that also has 100% control over Russia's gas pipeline network. O'Brien said Rosneft flares many billions of cubic meters of gas that it could otherwise sell, if only Gazprom would give it equal access to its pipelines. He complained that because no authority other than Gazprom has access to pipeline capacity and availability information, Gazprom could effectively shut out potential competitors. Schrader's complaints were virtually identical. Mikhailiants noted growing discontent within the GOR over Gazprom and expressed hope that this could develop into a push to split Gazprom into separate production and transportation companies. O'Brien was supportive of the idea, but noted that the current gas glut and Gazprom's consequent troubles (ref A) would likely preclude such a move by the GOR for many years.

17. (C) Bluntly commenting on Gazprom's various priorities, Schrader called both the Shtokman gas project and the South Stream pipeline "total wastes of money." He added that Gazprom's planned expenditures of tens of billions of dollars to develop the Yamal region is "stupid" given that TNK-BP and other companies could feed so much gas into Gazprom's systems "at a fraction of the cost" of new Yamal gas. Schrader also offered advice on Europe, saying that now (an era of oversupply) is the time for "Europe to get its act together" if it wants to further reduce imports of Russian gas. He said Europe's diversification plans should include Nabucco, but added that Nabucco would depend on Shah Deniz gas from Azerbaijan.

18. (C) DFM Denisov admitted that Russia "is heavily dependent on Europe for gas revenues." He lamented that the media inaccurately portray the Russian-EU energy trade as European dependence on Russian gas, when the real situation may be the opposite -- "We supply 25% of their gas market, but we get 65% of our total gas revenues from them."

CHINA

19. (C) Responding to SE Morningstar's questions about the role of China in the Russian and Central Asian energy picture, all interlocutors observed that it would expand. Schrader called growing Chinese consumption of both Central Asian and Russian hydrocarbons "inevitable." O'Brien explained the natural fit between Chinese and Russian interests. He said China sees investment opportunities in the raw materials sectors as both satisfying its economy's need for inputs as well as a means by which to diversify away from its vast holdings of U.S. Treasury securities. Meanwhile, from Rosneft's and Russia's perspective, China presents the largest potential future market for oil, gas, and other natural resources.

110. (C) DFM Denisov agreed on China's importance to Russia's oil and gas future, noting that China is a "customer, collaborator, and competitor." He complained, however, about on-going disagreements, especially on the price of gas. He said the "very low" coal-based gas price formula on which China is insisting "is not acceptable" as Russia prefers "more reliable financial schemes."

MFA: "BE CAREFUL IN THE CASPIAN"

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111. (C) Denisov had a vague warning on activities in the Caspian region, calling for a "careful" approach to avoid any "unpredictable consequences." He added that Caspian issues are "very sensitive" and that all actors need to move "very cautiously." O'Brien independently observed Russian agitation and concern over U.S. activities in the Caspian, an area where Russia believes the U.S. has no clear energy interests.

112. (C) Denisov stressed the need to take into consideration the "legal, political, economic, and environmental" concerns of all five Caspian countries, including Iran. He called Iran "a good partner" in the dialogue among the Caspian countries, but said that Turkmenistan, Kazakhstan, and Azerbaijan do not support Iran's suggestion of a Caspian Economic Cooperation Organization. He specified the need for "special efforts" to protect the environment, and shared "strong reservations" about pipelines crossing the Caspian Sea. SE Morningstar stated the USG has no hidden agenda with respect to the Caspian and that we believe the Caspian states should make their own decisions regarding their economic and political development.

COOPERATION

113. (C) SE Morningstar outlined to DFM Denisov his views for the Bilateral Presidential Commission's Sub-Working Group on Energy Security, emphasizing the need for open dialogue on a range of topics in order to de-politicize energy issues. Denisov was optimistic and supportive of SE Morningstar's vision for bilateral cooperation and discussion. He noted, however, "inter-agency difficulties" as one of the reasons the Russian side does not yet have a specific counterpart for SE Morningstar. On multilateral cooperation, Denisov reiterated Russia's desire to see a new framework on

international energy cooperation that contains "binding principles that protect the rights of producers, consumers, and transit countries." He said the Ministry of Energy is working on the details of the Russian proposal announced by President Medvedev in April (ref B). Ambassador Morningstar reiterated our support of the St. Petersburg G8 Energy Principles and offered our willingness to consider any future Russian proposals.

¶14. (U) SE Morningstar has cleared this cable.
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